

INTERNAL REVENUE SERVICE

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[REDACTED]

Dear [REDACTED]

Your March 29, 2000, inquiry on behalf of your constituent, [REDACTED], was forwarded to this office for response on August 11, 2000, by [REDACTED]

[REDACTED] is concerned about the tax appearing on his telephone bill imposed on frequent flyer miles he received for switching long distance providers.

As enacted by the Congress, the Taxpayer Relief Act of 1997 added section 4261(e)(3) to the Internal Revenue Code to provide a 7.5 percent federal excise tax on amounts paid for the right to award frequent flyer miles.

When a business, such as a long distance provider, purchases the right to award frequent flyer miles to a customer, it pays tax to the air carrier selling the miles. The air carrier then pays the tax to the United States. Because the customer is not paying any amount for the right to award frequent flyer miles, this tax does not apply to the transaction between the customer and the long distance provider. The provider may be showing on its invoice (the telephone bill) to the customer an amount representing the tax that was paid on its purchase of the frequent flyer miles from the air carrier, but the tax does not apply to the customer's receipt of the miles as a consequence of its switching providers. However, no federal excise tax provision prohibits a business from passing its costs of doing business on to its customers.

This tax, as well as several other federal excise taxes relating to air transportation, is paid into the Airport and Airway Trust Fund (the Trust Fund). Amounts in the Trust Fund are used to plan, construct, develop, operate, and maintain air traffic control, air navigation, and communications for the airway system. In addition certain portions of the budget of the Department of Transportation concerned with air transportation and air safety, including over one-half of the expenditures of the Federal Aviation Administration, come from the Trust Fund.

I hope this information is helpful to you in responding to your constituent. If you have any questions, please contact me at [REDACTED]

Sincerely,

Paul F. Kugler
Associate Chief Counsel
(Passthroughs and Special Industries)